

July 31, 2007

President Bush Signs Exon-Florio Reform Legislation

On July 26, the President signed into law the Foreign Investment and National Security Act of 2007 (the “Act”). The Act revised Section 721 of the Defense Production Act of 1950 (50 U.S.C. app § 2170), commonly known as the “Exon-Florio Amendment” or simply “Exon-Florio,” effective 90 days after the signing by the President. Although the Act should not bring about dramatic changes in terms of US national security reviews of acquisitions by foreign companies and nationals, it does reinforce the heightened scrutiny that has existed since the political firestorm over the Dubai Ports World transaction in early 2006. A number of major business groups supported the legislation, on the grounds that it would prevent Congress from continuing to revisit the Exon-Florio process, and that it was distinctly preferable to reform bills that died in Congress last year.

I. Background on the Exon-Florio Amendment

The Exon-Florio Amendment was added to the Defense Production Act in 1988, and, up until the Act, has undergone only modest revisions. It provides the President with the authority to investigate and, where necessary, block or unwind mergers and acquisitions by foreign persons that could threaten national security. The President’s Exon-Florio powers apply whenever a foreign company or national is acquiring control over an existing US company or business, directly or indirectly, regardless of whether the US company or business is already foreign-owned and regardless of whether the transaction at issue is one foreign company buying another foreign company.

Since shortly after the Exon-Florio Amendment became law, the President’s investigatory powers (but not his power to block or unwind transactions) has been exercised by an interagency group chaired by the Treasury Department – the Committee on Foreign Investment in the United States (“CFIUS”). Through the Treasury Department, CFIUS has issued implementing regulations (31 C.F.R. Part 800), which specify the types of information and documentation that must be supplied in an Exon-Florio filing.

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Under the Exon-Florio Amendment, there is no requirement for transaction parties to make an Exon-Florio filing. However, making the filing and undergoing CFIUS review is the only way to terminate the President's power to block or reverse an acquisition. In the absence of a voluntary filing on a transaction, any CFIUS agency can ask for commencement of an Exon-Florio review. As a consequence, the transaction parties (and especially the acquirer) will typically want to make an Exon-Florio filing where the transaction appears to raise any meaningful national security issues. This is a somewhat amorphous test, in that neither the Exon-Florio Amendment nor the implementing regulations define "national security" – and the ambit of transactions that may raise national security issues has expanded in recent years, first following the events of 9/11 and then after the Dubai Ports World transaction last year.

Given the challenges of the Exon-Florio review process, the transaction parties almost always make a joint Exon-Florio filing and work together closely before and during the review process. The Exon-Florio Amendment sets forth a time frame for the review process that in theory is limited to 90 days. In practice, the time frame is more fluid, due both to pre-filing activities and to the ability to withdraw and re-file when problems are encountered. The statutory time frame is as follows: within 30 days of receiving a complete Exon-Florio filing, CFIUS must conclude its preliminary review and determine whether to undertake a formal investigation of the transaction; if CFIUS decides to conduct a formal investigation, it has a further 45 days to complete its inquiry and report its findings and recommendations to the President; the President then has 15 days in which to decide what action, if any, to take with respect to the transaction. In practice, the vast majority of Exon-Florio reviews are concluded within the 30-day preliminary review phase – although often with conditions imposed by CFIUS agencies.

II. The Foreign Investment and National Security Act of 2007

In 2006, after CFIUS's clearance of Dubai Ports World's acquisition of a UK company whose US subsidiary was engaged in terminal loading/unloading at a number of US ports produced a political firestorm in Congress, both the Senate and the House of Representatives passed bills to "fix" the CFIUS process. This legislation died when the Senate and House were unable to resolve their differences, but the House took up the effort again in February of this year, passing an Exon-Florio reform bill (H.R. 556) that was similar in many respects to the bill the House had passed last year. In June of this year, after taking account of a number of Bush Administration and business community comments on the House bill, the Senate passed its own version of H.R. 556 which, in most respects, moved the bill in a direction favorable to foreign investment. Earlier this month, the House took up the Senate-passed version of H.R. 556 and, rather than insisting on a House-Senate conference to resolve the differences, approved the Senate-passed version of the bill.

The Act addresses a number of Congressional concerns with the Exon-Florio process, but in ways that should not have a dramatic impact on how cases are handled after Dubai Ports World. The Act for the first time addresses the composition, powers, and responsibilities of CFIUS, which had previously been determined by the President by executive order. In addition, the Act provides for extensive reporting to, and briefing of, Congress with respect to individual Exon-Florio cases and how the Exon-Florio process is working; but no reporting or briefing is required on an Exon-Florio case before CFIUS or the President has closed the case. The Act also

reinforces certain elements of the CFIUS review process that had already been introduced by the Bush Administration after the Dubai Ports World controversy, each of which adds to the rigor of the review process. These include (i) high-level review and sign-off on all Exon-Florio cases, (ii) performance of intelligence agency threat assessments for every case, (iii) heightened sensitivity to foreign control over critical infrastructure, and (iv) increased emphasis on the use and enforcement of mitigation agreements and other conditions.

In the latter area, aside from a general directive to CFIUS to increase oversight and enforcement of mitigation agreements and other conditions that may be imposed during the Exon-Florio review process, the Act contains several concrete measures aimed at formalizing the use and enforcement of conditions to CFIUS approval. First, the Act requires the Treasury Department to designate a “lead agency” for each Exon-Florio case, with responsibility for negotiating and monitoring mitigation agreements and other conditions. Second, the Act provides CFIUS with the power to reopen review of a transaction that has already been cleared by CFIUS or the President where the acquirer or the acquired US company or business intentionally fails to comply with material commitments made during the course of the Exon-Florio process. Third, in a rather unusual provision, the Act provides for the imposition of unspecified civil penalties for failure to comply with mitigation agreements or other conditions imposed by CFIUS agencies, and assigns CFIUS the task of identifying these penalties in its implementing regulations.

Finally, the Act directs CFIUS to issue implementing regulations no later than 270 days after the signing by the President. Although the Treasury Department will undoubtedly provide informal guidance in interpreting the Act to transaction parties making Exon-Florio filings over the next several months, we do not anticipate any formal guidance until the new regulations are issued.

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This memorandum is not intended to provide legal advice with respect to any particular situation, and no legal or business decision should be based solely on its contents. Questions concerning the issues addressed in this memorandum should be addressed to the following members of our Corporate Department:

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